IN THE COURT OF APPEALS OF TENNESSEE
AT NASHVILLE
July 9, 2004 Session

STATE EX REL. PAULA FLOWERS v. TENNESSEE COORDINATED CARE NETWORK, ET AL.

Appeal from the Chancery Court for Davidson County
No. 01-3206-III Ellen H. Lyle, Chancellor

No. M2003-01658-COA-R3-CV - Filed February 23, 2005

Tennessee Coordinated Care Network (TCCN), a health maintenance organization (HMO), contracted with the State of Tennessee to provide health services to participants in the State's TennCare program. When TCCN failed to comply with its contractual and regulatory requirements, the Department of Commerce and Insurance placed TCCN under Notice of Administrative Supervision. TCCN was specifically prohibited from transferring any of its assets without the approval of the Commissioner. TCCN requested permission to transfer $5.7 million to Medical Care Management Company to pay "outreach expenses." The request was denied. Nevertheless, the disputed funds were transferred to Care Management, which immediately transferred the funds to its holding company, Access Health Systems, Inc. The Commissioner immediately commenced proceedings in Chancery Court to recover the disputed funds. Access and Care Management then filed bankruptcy, subjecting the money to the automatic stay. The Bankruptcy Court lifted the stay and authorized the Chancery Court to determine ownership of the funds. The Chancery Court imposed a constructive trust effective the date of the unauthorized transfer, which preceded the bankruptcy petitions. The Bankruptcy Estates of Access and Care Management appeal. We affirm.

Tenn. R. App. P. 3 Appeal as of Right; Judgment of the Chancery Court Affirmed

FRANK G. CLEMENT, JR., J., delivered the opinion of the court, in which WILLIAM C. KOCH, JR., P.J., M.S., and WILLIAM B. CAIN, J., joined.

Andy Rowlett, Nashville, Tennessee, for the appellant, The Bankruptcy Estate of Access Health Systems, Inc.[1]

Jason D. Holleman and William H. Farmer, for the appellee, State of Tennessee, ex rel. Paula A. Flowers, Commissioner of Insurance for the State of Tennessee.

---

[1] The Bankruptcy Estate of Medical Care Management also appealed but did not file a brief. It adopted the brief of the Bankruptcy Estate of Access. Tennessee Coordinated Care Network did not participate in the appeal.

OPINION

TCCN[2] contracted with the State of Tennessee in 1994 to provide health services to participants in the State's TennCare program. It operated the TennCare health plan known as "Access...*Med* Plus." TCCN sustained major financial losses during its first year. By 1995 the State claimed that TCCN was not meeting various contractual and regulatory requirements, one of which was a deficient net worth.

In an attempt to improve its net worth, TCCN entered into an agreement with the recently formed Medical Care Management Company (Care Management) to sell most of its assets.[3] The principal, if not only, asset TCCN was to retain was the managed care contract with the State of Tennessee. Pursuant to the agreement, TCCN received cash from Care Management which TCCN used to satisfy, *albeit* temporarily, the minimum net worth requirement. Contemporaneous with these transactions, Access Health Systems, Inc. (Access) was organized as the holding company for Care Management.[4]

TCCN also entered into a management contract with Care Management at the same time it sold most of its assets. While the description of services are somewhat disputed, Care Management was to provide management services for TCCN, health promotion and outreach services.

Thereafter, TCCN's financial condition again worsened. Additionally, the State took exception with what it described as deficiencies with the processing of claims of TennCare recipients. As a consequence, on May 10, 2000, the Tennessee Department of Commerce and Insurance placed TCCN under a Notice of Administrative Supervision pursuant to Tenn. Code Ann. § 56-9-510. The Notice of Administrative Supervision contained the following provisions pertinent to this case:

> 8. During the period of supervision, the HMO may not make any disbursements or do any of the following things without the prior written approval of the Commissioner or the Commissioner's appointed Supervisor:
>
> a. Dispose of, convey or encumber any of its assets or its business in force;
> b. Withdraw any of its bank accounts;

[2] Tennessee Coordinated Care Network was organized in 1983 under the name Tennessee Primary Care Network. The corporate name was changed prior to the events in dispute.

[3] Documents filed with the secretary of State identified Care Management's principal offices as 210 Athens Way, Nashville, TN, being the same address as TCCN.

[4] The record suggests Care Management was wholly owned by Access Health Systems, Inc., yet in another part of the record it suggests that Care Management was wholly owned by Medical Care Management Company, USA, which in turn was wholly owned by Access.

. . . .

e. Transfer any of its property.

The effective time period of the Notice of Administrative Supervision was extended twice by agreement so that the prohibition against transfer of TCCN's funds, without express permission of the Supervisor,[5] was in effect when the transaction at issue took place on October 16, 2001.

Initially, TCCN requested that the Supervisor approve the transfer of $5.7 million to Care Management to pay for "outreach expenses." The Supervisor denied the request, finding that TCCN's management agreement with Care Management made those expenses the responsibility of Care Management. By letter dated June 21, 2000, the Supervisor expressly denied the request. TCCN challenged several of the Supervisor's decisions in an Administrative Procedures Act proceeding, but failed to challenge the Supervisor's denial of the "outreach expenses."

On October 16, 2001, Mr. Anthony J. Cebrun, "authorized agent" of TCCN, who was also president and chairman of Access and Care Management, instructed AmSouth Bank to transfer the disputed funds, $5.7 million, from the TCCN account to a Care Management account. Mr. Cebrun's decision to pay the "outreach expenses" was directly in contradiction of the express denial of the Supervisor and thus violated the terms of the agreed Notice of Administrative Supervision by the Tennessee Department of Commerce and Insurance. Once the funds were transferred to Care management's account, they were immediately "swept" – automatically transferred pursuant to standing instructions – to an Access account.[6]

Upon learning of the unauthorized transfer, the Commissioner filed an application for temporary restraining order, requesting that the money be frozen at AmSouth Bank pending the final resolution of the matter. On October 17, 2001, the Chancellor granted the Commissioner's application and issued a temporary restraining order freezing the money. Also, on this date the Commissioner filed a petition with the Chancery Court, requesting the appointment of a receiver for the purpose of liquidating TCCN. On October 18, 2001, the Chancery Court issued an order of seizure of TCCN, which included the issuance of a temporary injunction continuing the terms of the previously-issued temporary restraining order.

On November 2, 2001, the Chancery Court ordered the liquidation of TCCN. On November 14, 2001, the Commissioner filed a petition in the Chancery Court seeking the return of the transferred funds. On December 17, 2001, before the Chancery Court rendered a final judgment related to the funds, Care Management and Access filed for bankruptcy.

---

[5] Courtney N. Pearre was appointed the Administrative Supervisor of TCCN on May 10, 2000. Mr. Pearre was also appointed Special Deputy Liquidator on November 2, 2001 for the purpose of liquidating TCCN.

[6] Pursuant to previous instructions, all funds deposited to Care Management's account at AmSouth were "swept" daily, and automatically, into the Access account.

On January 2, 2003, the Bankruptcy Court lifted the automatic bankruptcy stay for the express purpose of allowing the Commissioner to pursue the petition to recover the funds pending in the Davidson County Chancery Court. On January 11, 2003, Access filed a motion to alter or amend the order, requesting that the stay relief be restricted to prevent the Chancery Court from imposing a constructive trust. The Bankruptcy Court denied Access' motion to alter or amend, stating that the Chancellor is "fully capable of deciding what law is applicable to the facts presented to her, whether it be state insurance law, state property law, the McCarran-Ferguson Act and/or federal law governing the imposition of constructive trusts or other remedies upon debtors in bankruptcy."

Following the lifting of the automatic bankruptcy stay, the Commissioner amended her Chancery Court petition to include a claim for imposition of a constructive trust upon the approximately $5.7 million (the disputed funds) on January 27, 2003. Thereafter, the Commissioner moved for summary judgment on her constructive trust claim. On April 25, 2003, Access responded on behalf of the defendants[7] and filed a cross-motion for summary judgment. Following a hearing, the Chancellor: (1) denied Access' motion for summary judgment, (2) granted the Commissioner's motion for summary judgment, (3) found that a constructive trust had arisen on October 16, 2001, the date of the transfer, as to the approximately $5.7 million at issue, and (4) ordered the money transferred to the liquidation estate of TCCN.

The Bankruptcy Estate of Access Health Service, Inc. and The Bankruptcy Estate of Medical Care Management appealed.[8]

Standard of Review

An appellate court's review of a motion for summary judgment is governed by well-settled standards. *Staples v. CBL & Associates, Inc.*, 15 S.W.3d 83, 88 (Tenn. 2000). Summary judgment is appropriate where the moving party establishes that there is no genuine issue as to any material fact and that a judgment may be rendered as a matter of law. Tenn. R. Civ. P. 56.04; *see also Bain v. Wells*, 936 S.W.2d 618, 622 (Tenn. 1997). The party moving for summary judgment bears the burden of demonstrating that no genuine issues of material fact exist. *Byrd v. Hall,* 847 S.W.2d 208, 211 (Tenn.1993). A trial court should grant a motion for summary judgment only if the movant demonstrates that there are no genuine issues of material fact and that the moving party is entitled to judgment as a matter of law. Rule 56.04 Tenn. R. Civ. P.; *Byrd,* 847 S.W.2d at 210. In reviewing a motion for summary judgment, this court must examine the evidence and all reasonable inferences in the light most favorable to the non-moving party and must discard all countervailing evidence.

[7] The defendants in the chancery court proceeding included the two bankruptcy estates of Access and Care Management. In addition thereto, "the Official Committee of Unsecured Creditors of Access Health Systems, Inc." and "the Official Committee of Unsecured Creditors of Medical Care Management Company" filed permissive motions to intervene in the action, which were granted prior to the filing of the summary judgment motions and the rulings thereon.

[8] Access is the only appellant to file a brief. Care Management filed a notice of appeal and thereafter a notice that it "adopts, in its entirety, the Brief of Appellant filed by the Bankruptcy Estate of Access Health Systems, Inc."

Mooney v. Sneed, 30 S.W.3d 304, 305-06 (Tenn. 2000); *Byrd v. Hall*, 847 S.W.2d 208, 210-211 (Tenn. 1993). If our review concerns only questions of law, the trial court's judgment is not presumed correct, and our review is *de novo* on the record. *Holt v. Holt*, 995 S.W.2d 68, 71 (Tenn. 1999) (citing *Warren v. Estate of Kirk*, 954 S.W.2d 722, 723 (Tenn. 1997)).

Issues

The ultimate issue is who owns the disputed funds. To answer this question, we must examine: (1) Whether the Chancery Court of Davidson County, Tennessee was authorized to rule in a manner that adversely impacted creditors rights in a bankruptcy proceeding, and (2) Whether the court erred by imposing a constructive trust, and, if not, whether the court correctly determined the effective date of the constructive trust.

Regulating the Business of Insurance in Tennessee

This action is in state court because the Bankruptcy Court correctly held that states regulate the business of insurance unless Congress passes a law that specifically relates to the business of insurance. The Bankruptcy Court found that the stay should be lifted because the McCarran-Ferguson Act created an exception to federal preemption in bankruptcy matters. The exception is known as "reverse preemption." In relevant part the McCarran-Ferguson Act at 15 U.S.C. § 1012(b) provides:

> No Act of Congress shall be construed to invalidate, impair, or supercede any law enacted by any State for the purpose of regulating the business of insurance . . . unless such Act specifically relates to the business of insurance.

The U. S. Supreme Court set forth three prerequisites to reverse preemption: (1) the federal statute does not specifically relate to insurance, (2) the state statute was enacted to regulate the business of insurance, and (3) the federal statute would invalidate, impair, or supercede the statute. *United States Dep't of Treasury v. Fabe*, 508 U.S. 491, 500-501 (1993). The Bankruptcy Code has general application, thus it does not specifically relate to the business of insurance.

Tennessee's Insurers Rehabilitation and Liquidation Act, Tenn. Code Ann. § 56-9-101, et seq., was enacted to regulate the business of insurance conducted in this state. The general purpose of the Insurers Rehabilitation and Liquidation Act is "the protection of the interests of insureds, claimants, creditors and the public generally. . . ." Tenn. Code Ann. § 56-9-101(d). The Act explains that this purpose is best accomplished by "[p]roviding for a comprehensive scheme for the rehabilitation and liquidation of insurance companies and those subject to this chapter as part of the regulation of the business of insurance, insurance industry and insurers in this state. Proceedings in cases of insurer insolvency and delinquency are deemed an integral aspect of the business of insurance and are of vital public interest and concern." Tenn. Code Ann. § 56-9-101(d)(7). The Bankruptcy Court judge correctly found:

> Tennessee's comprehensive Insurers Rehabilitation and Liquidation Act, T.C.A. § 56-9-101, et seq., and those portions of the Act implicated here, are designed to "regulate the business of insurance" as defined by *Fabe* and the cases following it. As in almost all of the above cases, the Act grants exclusive jurisdiction for cases arising under it to the Chancery Court of Davidson County, where a failing or insolvent insurer's assets can be marshaled, supervised, and protected from wasteful litigation in many forums through an orderly and uniform liquidation process. T.C.A. § 56-9-104(e). As in many of the cases above, the Act provides further that after an order of liquidation, "no action at law or equity or in arbitration shall be brought against the insurer or liquidator . . . nor shall any such existing actions be maintained or further presented . . . ." T.C.A. § 56-9-313(a)(1).
>
> As illustrated further in other provisions implicated here, this exclusive jurisdictional grant to one court is designed to protect policyholders and their agreements for risk transfer through the provision of a uniform process. The Chancery Court of Davidson County alone may issue orders for liquidation and seizure of assets such as those issued by the Chancery Court against the respondents, TCCN, [Care Management], and [Access] (T.C.A. § 56-9-201). The Chancery Court of Davidson County alone (T.C.A. § 56-9-104(e)) may issue orders requiring the cooperation of closely affiliated or managing entities such as [Care Management] or [Access] in the liquidation process (T.C.A. §56-9-106); and orders allowing the liquidator to avoid fraudulent and/or preferential transfers as alleged in the Commissioner's Petition to Recover (T.C.A. §§ 56-9-315 and 317). The inescapable conclusion from these provisions is that Tennessee's Insurers Rehabilitation and Liquidation Act, as a whole and its specific provisions implicated here, is aimed at protecting the relationship between policyholders and insurers and safeguarding their risk shifting agreements. This purpose is accomplished through the grant of exclusive jurisdiction to the Chancery Court of Davidson County to enter orders of liquidation, seizure, and all other orders necessary to marshal and distribute assets of failed insurance companies.
>
> The Commissioner's motion in this Court seeks the resolution of the dispute between the insurer's liquidator and [Care Management] and [Access] in the one forum specifically designed to protect the policyholder (in this case the TennCare Bureau) and its risk transfer agreement through the orderly liquidation process established by the Tennessee legislature. Therefore, the provisions of T.C.A. § 56-9-101, et seq., are designed to regulate the business of insurance as envisioned under the McCarran-Ferguson Act.

Thus, there is a Tennessee statute that regulates the business of insurance, which satisfies the second prerequisite. Therefore, we are left with the third *Fabe* prerequisite, whether the bankruptcy proceeding would operate to invalidate, impair or supercede Tennessee's regulatory scheme. The bankruptcy judge succinctly addressed this, as well, in her ruling:

> Whether by force of the current stay or by this Court's decision as to the alleged transfer and ownership of the funds, those portions of the Insurers Rehabilitation and Liquidation Act giving the Chancery Court of Davidson County exclusive jurisdiction over all actions under the Act would be invalidated, impaired, or superceded under the McCarran-Ferguson Act. *The simple exercise of this* [Bankruptcy] *Court's jurisdiction to decide whether the alleged transfer was valid and who owns the disputed funds or to preclude the Chancery Court from deciding these issues, without more, impinges upon and negates the obvious intent of the state legislature to consolidate all liquidation proceedings in one special court for the reasons stated previously.* Moreover, if a case involves a violation of a supervisor's orders under the Act, such as those entered here for preapproval of disbursements, a liquidator may be required to pursue his claim of ownership in another, sometimes distant forum, having no acquaintance with the Act or the ongoing liquidation and the orders entered therein. (emphasis added)
>
> . . . .
>
> *Accordingly, the operation of the Bankruptcy Code, whether by continuing the automatic stay or by entertaining an inevitable action to determine whether a valid transfer occurred and ownership of the disputed funds, "invalidates, impairs or supercedes" the grant of exclusive jurisdiction to the Chancery Court of Davidson County under the Insurers Rehabilitation and Liquidation Act.* The stay should, therefore, be lifted for cause because the McCarran-Ferguson Act reverse-preempts the Bankruptcy Code in this instance. (emphasis added)

We are in agreement with the bankruptcy judge's conclusion and see no reason to elaborate further. Accordingly, pursuant to The Insurers Rehabilitation and Liquidation Act, Tenn. Code Ann. § 56-9-101, et seq., it is up to the Chancery Court of Davidson County, Tennessee and the appellate courts of this state to determine who owns the disputed funds.

Constructive Trust

Access challenges the Chancellor's finding of a constructive trust on several fronts. It contends that the elements for conversion must be met to justify a constructive trust. It also contends that imposition of a constructive trust contradicts federal bankruptcy law because it prevents ratable distribution of the disputed funds, which undercuts the Bankruptcy Code's policy of making ratable distribution among all creditors.

In imposing a constructive trust on the disputed funds, the Chancellor ruled:

> The Court's analysis of the foregoing facts is that they establish as a matter of law grounds for imposition of a constructive trust. TCCN had possession of the funds in its bank account and a defensible claim to them. Anthony J. Cebrun had agreed and voluntarily assumed an express duty under the Notice of Administrative

> Supervision to obtain approval of Supervisor Pearre before transferring funds. Mr. Cebrun, as the head of [Care Management] managing TCCN, and as per his agreement to the Notice of Administrative Supervision, was in a position of trust. Additionally Mr. Cebrun cannot claim mistake or confusion. He knew, when he effected the transfer, that the Supervisor had denied repeatedly [Care Management's] claim to the funds and would not approve the transfer. Finally, Mr. Cebrun had a remedy by statute of an administrative proceeding to press his contest over the ownership of the funds. Under all of these circumstances, Mr. Cebrun's transfer of the funds was the kind of act from which a constructive trust arises *ex maleficio*. Mr. Cebrun procured possession of the property in violation of an express duty to the Commissioner, and Mr. Cebrun made use of his position as manager and party to the Notice of Administrative Supervision to obtain possession of the funds on more advantageous terms than could otherwise have been obtained.
>
> But what takes this case out of the ordinary remedy of constructive trusts and provides a heightened basis for imposing a trust is that the transfer violated the Administrative Supervision. Although the Supervision does not have the standing of a court proceeding and is more akin to an administrative one, nevertheless the Administrative Supervision is created and provided for by statute. Its purpose is to protect the public. The Administrative Supervision is part of a statutory scheme to provide health insurance to indigent or uninsured persons and to protect the citizens of the State of Tennessee. Thus, breaching the Notice of Administrative Supervision is more than breaching a private contract or partnership agreement. The breach has far-reaching, public ramifications, and it is egregious. These public concerns provide a heightened basis for the intervention in equity. Just as the court in *Morris* found that there was a heightened basis for the equitable remedy of imposing a constructive trust where the nonmovant gained legal title by violating the terms of a court ordered settlement, this Court finds that there is a heightened basis for the equitable remedy of imposing a constructive trust where the nonmovant gained possession of the funds by violating the Notice of Administrative Supervision issued by the State.

Judge Cardozo viewed a constructive trust as "the formula through which the conscience of equity finds expression." *Beatty v. Guggenheim Exploration Co.*,122 N.E. 378, 380, 225 N.Y. 380, 386 (N.Y. Ct. App. 1919). He further opined that equity works through a constructive trust "when property has been acquired in such circumstances that the holder of the legal title may not in good conscience retain the beneficial interest equity converts him into a trustee." *Id*. Some element of fraud, concealment, duress, etc., such that a person has obtained property "which he ought not, in equity and good conscience, hold and enjoy" is required for a constructive trust. *Roach v. Renfro*, 989 S.W.2d 335, 341 (Tenn. Ct. App. 1998).

In Tennessee, a constructive trust may be imposed where: (1) a person procures the legal title to property in violation of a duty to the actual owner; (2) the title to property is obtained by some inequitable means; (3) a person makes use of some influence in order to obtain title on better terms than it otherwise would have been obtained; (4) a person acquires property with notice that someone else is entitled to its benefits. *Estate of Queener v. Helton*, 119 S.W.3d 682, 687 (Tenn. Ct. App. 2003); *see also Tanner v. Tanner*, 698 S.W.2d 342, 345-346 (Tenn.1985).

Conversion is the appropriation of tangible property to a party's own use in exclusion or defiance of the owner's rights. *Barger v. Webb*, 391 S.W.2d 664, 665 (Tenn. 1965); *Lance Prods., Inc. v. Commerce Union Bank*, 764 S.W.2d 207, 211 (Tenn. Ct. App. 1988). Conversion is an intentional tort, and a party seeking to make out a prima facie case of conversion must prove: (1) the appropriation of another's property to one's own use and benefit, (2) by the intentional exercise of dominion over it, (3) in defiance of the true owner's rights. *Kinnard v. Shoney's, Inc.*, 100 F.Supp.2d 781, 797 (M.D. Tenn. 2000); *Mammoth Cave Prod. Credit Ass'n v. Oldham,* 569 S.W.2d 833, 836 (Tenn. Ct. App. 1977). Property may be converted in three ways. First, a person may personally dispossess[9] another of tangible personalty. Restatement (Second) of Torts § 223(a) (1965). Second, a person may dispossess another of tangible property through the active use of an agent. *See, e.g., McCall v. Owens*, 820 S.W.2d 748, 751 (Tenn. Ct. App. 1991). Third, under certain circumstances, a person who played no direct part in dispossessing another of property, may nevertheless be liable for conversion for "receiving a chattel."[10] Restatement (Second) of Torts § 223(d).[11]

The required elements to prove a claim for conversion and to establish a constructive trust are similar; however, we find nothing in our jurisprudence which mandates that the elements of conversion are essential elements for establishing a constructive trust. Thus, we find the contention by Access that the Commissioner must prove the elements of conversion to prevail on the constructive trust claim without merit.

Access' next argument is that imposition of a constructive trust contradicts federal bankruptcy law because it prevents ratable distribution of the disputed funds. Ratable distribution to creditors, Access contends, will only occur if the Access bankruptcy estate receives the disputed funds. Upholding the constructive trust, Access argues, would allow the State to completely circumvent the Bankruptcy Code's equitable system of distribution. It principally relies on two cases to make this argument, *Poss v. Morris*, 260 F.3d 654 (6^{th} Cir. 2001) and *XL Datacomp, Inc. v Wilson*

---

[9] "Dispossess" means to intentionally take tangible personal property without the owner's consent and includes obtaining possession by fraud. Restatement (Second) of Torts § 221.

[10] Receiving a chattel means to accept it from an intermediary, who is not an agent, with the intent to acquire it away from the owner. Restatement (Second) of Torts § 229; *see, e.g., Huffman v. Hughlett*, 79 Tenn. 549, 555 (1883).

[11] Two or more persons may be held jointly and severally liable when they intentionally unite in the wrongful act causing the injury, *Hale v. Knoxville*, 226 S.W.2d 265, 269 (Tenn. 1949), and it may be imposed on all who actively participate in the tortious acts, who intentionally aid the acts, or who ratify tortious acts done for their benefit. *Hux v. Butler*, 339 F.2d 696, 699 (6th Cir. 1964). In appropriate circumstances, joint and several liability is appropriate for conversion claims. *See, e.g., Breeden v. Elliott Bros.*, 118 S.W.2d 219, 220 (Tenn. 1938).

(In re Omegas Group, Inc.), 16 F.3d 1443 (6th Cir. 1994). *Poss* stands for the proposition that imposition of a constructive trust is not proper if doing so affects ratable distribution. *Id*. at 666. *Omegas* stands for the proposition that "[c]onstructive trusts are anathema to the equities of bankruptcy since they take from the estate, and thus directly from competing creditors, not from the offending debtor." *Id*. at 1452.

The Commissioner counters relying primarily on *Kitchen v. Boyd (In re: Newpower)*, 233 F.3d. 922 (6th Cir. 2000), and to a degree on *Poss*, which Access also cites. *Newpower,* the Commissioner argues, provides that state law – not bankruptcy law – shall be applied to determine the effective date of a creditor's judgment in a state court action that was initiated pre-petition but concluded post petition. *Poss*, the Commissioner asserts, affirmatively holds that a bankruptcy court may give effect to a state court judgment involving a constructive trust obtained post petition in an action that was initiated pre-petition.

Anthony Cebrun, "authorized agent" of TCCN – also president and chairman of Access and Care Management – instructed AmSouth Bank to transfer the disputed funds, $5.7 million, from the TCCN account to a Care Management account. The day after the unauthorized transfer of the funds, the Commissioner filed this action requesting a temporary restraining order to freeze the funds. The TRO was granted and later converted to a temporary injunction. Before a final judgment could be obtained, Care Management and Access filed their petitions in bankruptcy. Thereafter, consistent with the holding in *Newpower*, the bankruptcy court lifted the stay so that the Chancery Court could determine whether a constructive trust existed.

In *Omegas*, upon which Access relies, the court commented, "The bankruptcy court is a little like a soup kitchen, ladling out whatever is available in ratable portions to those standing in line; nonetheless, scarcity begets innovation in the hungry creditor's quest to get a little more than the next fellow." *Omegas* at 1445. Following that analogy, under what circumstances should a creditor be allowed to cut to the front of the line and get as much soup as he thinks he is entitled to through the remedy of a constructive trust?

The parties in *Omegas* were in the business of re-marketing IBM computers. Datacomp, because of a deal it struck with IBM, needed to acquire IBM computers from a source other than IBM, thus Datacomp got Omegas to supply it with computers. Omegas disclosed to Datacomp that it was considering filing for bankruptcy and suggested that if Datacomp would loan it $1.6 million, Omegas would be able to fulfill its contractual obligations to Datacomp. Datacomp did not receive the suggestion warmly and after the meeting its counsel sent Omegas a letter accusing Omegas of fraud and demanding the return of money that Datacomp had paid to Omegas. Without telling Datacomp, Omegas requested that IBM cancel all deliveries, purportedly to render the 5% cancellation fee a prepetition debt. This cancellation meant that Datacomp paid for computers it would not receive. The next day Omegas filed for bankruptcy, and ten days later Datacomp filed its complaint in bankruptcy seeking the imposition of a constructive trust on a significant portion of the $1.1 million it paid Omegas. The bankruptcy court imposed a constructive trust finding that before the bankruptcy was filed, Omegas had stopped paying IBM, yet continued to invoice

Datacomp and deposited Datacomp's payment. The court found that Omegas had an affirmative duty to inform Datacomp of its financial situation and thus imposed the constructive trust on payments made by Datacomp after the date on which Omegas stopped paying IBM. *Id*. at 1445-1447.

According to the court in *Omegas*, a constructive trust is, unlike an express trust, nothing more than a claim. The *Omegas* court distinguished the two stating:

> A debtor that served prior to bankruptcy as trustee of an express trust generally has no right to the assets kept in trust, and the trustee in bankruptcy must fork them over to the beneficiary. However, a claim filed in bankruptcy court asserting rights to certain assets "held" in "constructive trust" for the claimant is nothing more than that: a claim. Unless a court has already impressed a constructive trust upon certain assets or a legislature has (footnote omitted) created a specific statutory right to have particular kinds of funds held as if in trust, the claimant cannot properly represent to the bankruptcy court that he was, at the time of the commencement of the case, a beneficiary of a constructive trust held by debtor.

Id. at 1449. The plea of the claimant trying to be first in line so as to get a full serving, the *Omegas* court contends, goes something like this:

> "Judge, due to debtor's fraud (or whatever), our property rights as beneficiaries of the constructive trust arose prepetition. Therefore, we stand not in the position of unsecured creditors, nor even equal to the trustee in the position of judgment creditors, but as the rightful owner of the *res* held in trust. Oh, and by the way, would you mind conferring on us these ownership rights and declaring that they arose prepetition?" This may seem silly phrased in this manner, but it is exactly the argument that most courts have accepted in holding that, due to some prepetition breach or bad act by the debtor, the claimed property or money is subject to a constructive trust and therefore "did not come into the bankruptcy estate and must be returned to the [debtor]" (citation omitted).

Id. at 1449-1450. Reversing the Bankruptcy Court, the *Omegas* Court reasoned that a constructive trust is at odds with the goals of the Bankruptcy Code.

> The reluctance of Bankruptcy Courts to impose constructive trusts without a *substantial reason* to do so stems from the recognition that each unsecured creditor desires to have his particular claim elevated above the others. Imposition of a constructive trust clearly thwarts the policy of ratable distribution and *should not be impressed cavalierly*. (our emphasis).

Id. at 1451 (quoting *The Oxford Organisation, Ltd. v. Peterson (In re Stotler and Co.)*, 144 B.R.385, 388 (1992)).

Further, the *Omegas* Court stated, "The equities of bankruptcy are not the equities of the common law. Constructive trusts are anathema to the equities of bankruptcy since they take from the estate, and thus directly from competing creditors, not from the offending debtor." *Id.* at 1452. Whatever equitable powers "remain in the bankruptcy courts must and can only be exercised within the confines of the Bankruptcy Code." *Id.* at 1453 (quoting *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 206 (1988)). Use of "such a relatively undefined equitable power" that favors one group of creditors over the other should only be done very cautiously since "ratable distribution among all creditors is one of the strongest policies behind the bankruptcy laws." *Omegas* at 1452 (quoting *In re North American Coin & Currency, Ltd.*, 767 F.2d 1573, 1575 (1985)). Moreover, the *Omegas* Court noted that the Code itself provided a specific remedy in the form of nondischargeable debts when a creditor proves that he was the victim of fraud or deceit. The court pointed out, however, that its holding did not address property "already impressed with a constructive trust by a court in a separate proceeding prepetition in which case the claimant would be entitled to priority." *Id.* at 1451.

So then, when does a creditor present a justification that is substantial enough to allow him to cut to the front of the line via imposition of a constructive trust. In *Newpower*, the money argued to be subject to a constructive trust was not money transferred in the ordinary course of business to a party – as it was in *Omegas* – the money was embezzled. The embezzler, Mr. Newpower, was part owner of a real estate investment company. Mr. Newpower accepted money from the other owners, the Kitchens, to purchase real estate; however, he embezzled much, but not all of the investor's money to purchase assets for his benefit, not the intended real estate. When the Kitchens realized their plight, they filed a complaint with the Michigan Attorney General's office and a police investigation ensued. Mr. Newpower subsequently pled guilty to embezzlement. He received a prison sentence and was ordered to pay $755,000 as restitution; *Newpower*, 233 F.3d at 927. However, Mr. Newpower filed bankruptcy before the state court declared the proceeds were subject to a constructive trust. *Id.* at 932.

With respect to funds Mr. Newpower embezzled but had not spent, the court found those funds were never part of the bankruptcy estate. *Id.* at 930. Whether property that Mr. Newpower purchased with the embezzled funds were subject to a constructive trust presented a more divisive issue for the *Newpower* court. Judge Batchelder, who authored the *Omegas* opinion, wrote the majority opinion in *Newpower* with respect to the constructive trust issue. She found significant differences between *Newpower* and *Omegas:*

> The trustee in this case argues that under *In re Omegas Group*, *Inc*., 16 F.3d 1443 (6th Cir.1994), the bankruptcy court may not impose a constructive trust, and, therefore, the Kitchens cannot recover their property ahead of the other creditors. However, *In re Omegas* simply held that because a constructive trust is a remedy that does not come into existence until it is judicially declared, a creditor claiming that a constructive trust should be impressed on particular property does not have an equitable interest in that property and 11 U.S.C. § 541(d) does not permit the bankruptcy court to exclude those assets from the estate by impressing them with a

> constructive trust postpetition. This is not the situation presented by the Kitchens' appeal. *In this case, the Kitchens initiated a state court action to recover the stolen property before the debtor filed his bankruptcy petition, and the sole reason that the state court has not yet issued a decision is the stay imposed by the bankruptcy court. Under these circumstances, nothing in In re Omegas prevents the lifting of the automatic stay so that the state court action may go forward.* (emphasis added)

Id. at 935. The majority went further to address the distinctions stating:

> *In re Omegas* dealt with a situation wherein the debtor obtained property from a creditor in the ordinary course of business. There was no question that the debtor had legal title; the creditor intended such title to pass to the debtor. The debtor also had a colorable claim as to the equitable title in the property at issue. The question in *In re Omegas*, and the other cases cited therein, was whether some fraudulent or other bad act of the debtor in the course of those business dealings justified the bankruptcy court in stripping the debtor of the equitable title in the property. We held that it was not the province of the bankruptcy court to impose a constructive trust, but we were not faced with the question of either obtaining or enforcing a state court judgment holding that the equitable interest belonged to someone other than the debtor. *See In re Omegas*, 16 F.3d at 1450.
>
> The situation presented by this case is significantly different. Here, Newpower is a thief. . . . To hold as Judge Kennedy would, that the lifting of the stay serves no purpose because *In re Omegas* precludes the enforcement of a constructive trust impressed by the state court under the circumstances of this case, and that here bare legal title is sufficient to bring this properly [sic] entirely within the bankruptcy estate is to permit a result clearly prohibited by the Bankruptcy Code. See 11 U.S.C. § 541(d). *Furthermore, to preclude the Kitchens from continuing their state court action to determine their equitable interest in the property would allow a thief, such as Newpower, unilaterally to convert stolen funds, in which the debtor has no title, into property of the bankruptcy estate simply by purchasing goods from an unknowing seller.* (emphasis added)

Id. at 935-936.

A key distinction between *Newpower* and *Omegas* was Mr. Newpower's unlawful conduct. Here, TCCN, acting by and through its president and chairman, Mr. Cebrun, willfully and unlawfully transferred the disputed funds in direct violation of the statutory Notice of Supervision. In paragraph 2 of the "specific terms" of the Notice of Supervision, Mr. Cebrun was identified by name, and charged with the statutory duty of cooperating with the Commissioner and the Supervisor. Subparagraph B of the Notice of Supervision provided that the Commissioner's supervision shall not be interfered with or obstructed. Paragraph 8 provided that TCCN was prohibited from transferring *any of its assets* without written approval of the Supervisor or the Commissioner. TCCN was expressly prohibited from transferring the disputed funds pursuant to the Notice of Supervision. Knowing that it was prohibited by the Notice of Supervision, TCCN requested permission to make the transfer. The Supervisor promptly and expressly denied the request, yet in October 2001, the defendants acted willfully and unlawfully by transferring the disputed funds, placing in motion the intended, automatic and prompt transfer of $5.7 million to Access via Care Management.

Appreciating the distinction between *Newpower* and *Omegas*, and that TCCN's act of transferring the disputed funds was willful and unlawful, we find that *Newpower* clearly supports imposition of a constructive trust in this case. This is because TCCN was under a Notice of Supervision that prohibited any transfers of assets, TCCN requested permission to transfer the disputed funds, the request was denied, yet in blatant disobedience thereof TCCN transferred the disputed funds.

The imposition of the constructive trust is further justified by the fact that the Commissioner acted promptly by filing an action for the appointment of a receiver and liquidation of TCCN one day after the unlawful transfer, on October 17, 2001, and filed the petition to recover the disputed funds one months after that, on November 14, 2001. Moreover, these actions were filed before Care Management and Access filed for bankruptcy, which was on December 17, 2001. On January 27, 2003, the Commissioner amended the petition, to include a claim for the imposition of the constructive trust at issue. The amended petition was filed after the bankruptcy petitions were filed. However, Tenn. R. Civ. Proc. 15.03 provides that such an amendment relates back to the date of the original pleading. Thus, the Commissioner's claim for imposition of a constructive trust predates the bankruptcy petitions by Care Management and Access.

Finding TCCN's unlawful conduct to be sufficiently similar to that in *Newpower* to justify the exception to the bankruptcy protocol of imposing a constructive trust, we therefore affirm the judgment of the Chancellor in this regard.

<u>Effective Date of the Constructive Trust</u>

Whether a judgment obtained by a creditor in a state court proceeding initiated prepetition but concluded postpetition following the lifting of the automatic stay has an effective date prior to the filing of a bankruptcy petition is a matter left to state law. *In re Morris*, 260 F.3d 654, 667 (6th Cir. 2001) (commenting on *Newpower*, 233 F.3d at 937).

Access argues that it was error for the trial court to impose a constructive trust effective October 16, 2001, the date of the transfer when its order imposing the constructive trust was not issued until October 23, 2003. Access argues that "a constructive trust arises not by intention but rather by act of a Court of equity to overcome the procuring of legal title in violation of some duty . . . ." citing *Browder v. Hite*, 602 S.W.2d 489, 493 (Tenn. Ct. App. 1980). Thus it argues that a constructive trust arises at the time the judicial decision imposes the trust.

The Commissioner counters, arguing that "a constructive trust relates back to the date of the wrong. That is, such a trust takes effect at the time of the wrongful act, as for example, the wrongful holding or acquisition of property." Citing 76 *Am. Jur*. 2d, Trusts § 204. The Commissioner asserts that Access is simply extending the holding in *Browder* beyond its intended context and that *Browde*r was not addressing the issue of when a constructive trust becomes effective. Further, the Commissioner urges that the effective date of a constructive trust has not been addressed by a Tennessee Court in detail.

Professor Scott in *Scott on Trusts*, insists the effective date of a constructive trust is when the asset is wrongfully acquired. He explains:

> Where the title to property is acquired by one person under such circumstances that he is under a duty to surrender it, a constructive trust immediately arises. . . . It has been suggested that the constructive trust does not arise until the defrauded person brings a suit in equity and the court decrees specific restitution. The notion seems to be that a constructive trust is created by the court and that it therefore does not arise until the court creates it by its decree. . . .
>
> There is no doubt that where the title to property is wrongfully acquired under such circumstances that the person acquiring it is under a duty to make restitution, the person entitled to restitution has such an interest in the property as to enable him to recover it from a person to whom the wrongdoer has transferred it, if that person is not a bona fide purchaser. This is true although the transfer is made before the person who was wronged has brought a proceeding to recover the property and long before the court has decreed restitution. The beneficial interest in the property is from the beginning in the person who has been wronged. The constructive trust arises from the situation in which he is entitled to the remedy of restitution, and it arises as soon as that situation is created. . . . It would seem that there is no foundation whatever for the notion that a constructive trust does not arise until it is decreed by a court. It arises when the duty to make restitution arises, not when that duty is subsequently enforced.

Scott on Trusts at § 462.4.

Professor Scott's view is not universally accepted. A difference of opinion exists as to the effective date of a constructive trust according to Bogert, *The Law of Trusts and Trustees*, § 472 (2d ed. 1978). The author explains, "Some courts have taken the position that the constructive trust arises at the time the property is wrongfully acquired, while other courts have stated that the trust arises only after the beneficiary exercises his election to seek a constructive trust and the court grants such relief, even though the defendant may be treated as a trustee from the date of his wrongful acquisition." There are a few bankruptcy cases arising in Tennessee which hold that constructive trusts do not come into existence until they are created by a court of equity; therefore, the effective date of the trust is the date the trust was created by the court. *In re Union Security Mortgage*, 25 F.

3d 338, 341 (6th Cir. 1994); *In re Tinnell Traffic Services, Inc.* 41 B.R. 1018, 1021 (M.D. Tenn. 1984); *North American Royalties, Inc. v. United States*, No. 1:96-cv-285, 1996 WL 679561 at *3(E.D. Tenn. 1996). This rationale appears to be based on the premise that constructive trusts are judicially created, thus the effective date is when the court enters an order creating the trust. We respectfully disagree with the underlying premise of these cases. Consistent with Professor Scott, we find that constructive trusts are created not by the court but by the wrongful act of the constructive trustee whose duties as trustee emanate the instant of the wrongful transfer.

The Chancellor recognized this when she established the effective date of the constructive trust as the date of the wrongful transfer, October 16, 2001, by citing the equitable maxim that "equity considers that as done which ought to be done." As Henry Gibson explains,

> In a Court of Chancery *ought to be becomes is*; and whatever a party ought to do, or ought to have done, in reference to the property of another, will ordinarily be regarded *as done*. The rights of the parties will be adjudicated as though, in fact, it *had been done*. This maxim is far-reaching in its operation, and full of beneficent consequences; the doctrines and rules creating and defining equitable estates or interests being, in a great measure, derived from it. (emphasis supplied)

Henry R. Gibson, *Gibson's Suits in Chancery*, § 2.12 (Inman rev., 8th ed. 2004).

Equity is described as "justice administered according to fairness as contrasted with the strictly formulated rules of common law. It is based on a system of rules and principles which originated in England as an alternative to the harsh rules of common law and which were based on what was fair in a particular situation."11 *Tennessee Jurisprudence*, Equity § 2. Equity does not permit a wrong to be suffered without a remedy and will devise a remedy appropriate to the situation:

> If through the ingenuity and subtlety of the human mind bent on schemes of personal or pecuniary advantages, or intent on devices for aggrandizement, new remedies should be required to overcome the insidiousness of any sort of Machiavellianism, the Court of Chancery, operating in obedience to these maxims, will devise a remedy adequate to the emergency, and vindicate the beneficence and capacity of its inherent powers to do justice in any case, and to right every wrong, however intricate the case, however great the wrong, or however powerful the wrongdoer. The powers that lie dormant in these potent maxims will awaken as the necessities for their action arise and they will be found commensurate with every necessity.

Gibson at § 2.02.

"It is clearly laid down, as a rule of equitable cognizance, that when an act has been prevented from being done by fraud, equity will consider it exactly as if it had been done." *Townsend v. Townsend*, 44 Tenn. (4 Cold.) 70; *Smart v. Waterhouse*, 18 Tenn. (10 Yer.) 94 (1836). *Cronbach v. Aetna Life Ins. Co.,* 284 S.W.72 (1925) holds that this maxim can only be invoked when the party against whom the complaint is made has failed or refused to perform some duty imposed on him. Furthermore, constructive trusts have been described as "judge-created trust(s) ... which enable(s) a court, without violating all rules of logic, to reach an interest in property belonging to one person yet titled in and held by another." *Wells v. Wells*, 556 S.W.2d 769, 771 (Tenn. Ct. App.1977).

This is precisely the situation here and the Chancellor was well within her equitable powers to set the date of the constructive trust as the date of the wrongful transfer. Thus, we affirm the finding by the Chancellor that the effective date of the constructive trust was October 16, 2001, the date of the wrongful transfer.

Other Issues Raised by Access

Access makes several other arguments. One is that imposition of a constructive trust conflicts with the Insurers Rehabilitation and Liquidation Act. It argues that the State based two counts of its claim to the disputed funds on Tenn. Code Ann. § 56-3-315 and 56-9-317, which Access asserts do not confer upon the State or its Supervisor the right to a constructive trust or equitable title to the funds. Instead, Access argues that Tenn. Code Ann.§ 56-9-302(a)(3) vests title to the insurer's assets in the rehabilitator. Access also argues that the Chancery Court erred in finding that imposition of a constructive trust mooted Access's argument that Tenn. Code Ann. § 56-9-315 and 317 merely made the transfer voidable as opposed to void.

The purpose of the Act is stated in Tenn Code Ann.§ 56-9-101, which states:

(b) This chapter shall not be interpreted to limit the powers granted the commissioner by other provisions of the law.
(c) This chapter shall be liberally construed to effect the purpose stated in subsection (d).
(d) The purpose of this chapter is the protection of the interests of insureds, claimants, creditors and the public generally, with minimum interference with the normal prerogatives of the owners and managers of insurers, through:
    (1) Early detection of any potentially dangerous condition in an insurer, and prompt application of appropriate corrective measures;
    (2) Improved methods for rehabilitating insurers, involving the cooperation and management expertise of the insurance industry;
    (3) Enhanced efficiency and economy of liquidation, through clarification of the law, to minimize legal uncertainty and litigation;
    (4) Equitable apportionment of any unavoidable loss;
    (5) Lessening the problems of interstate rehabilitation and liquidation by facilitating cooperation between states in the liquidation process, and by extending the scope of personal jurisdiction over debtors of the insurer outside this state;

(6) Regulation of the insurance business by the impact of the law relating to delinquency procedures and substantive rules on the entire insurance business; and

(7) Providing for a comprehensive scheme for the rehabilitation and liquidation of insurance companies and those subject to this chapter as part of the regulation of the business of insurance, insurance industry and insurers in this state. Proceedings in cases of insurer insolvency and delinquency are deemed an integral aspect of the business of insurance and are of vital public interest and concern.

Tenn. Code Ann. § 56-9-310 empowers the liquidator to *inter alia*:

(a) (15) Prosecute any action which may exist in behalf of the creditors, members, policyholders or shareholders of the insurer against any officer of the insurer, or any other person;

. . . .

(21) Exercise and enforce all the rights, remedies and powers of any creditor, shareholder, policyholder or member, including any power to avoid any transfer or lien that may be given by the general law and that is not included under §§ 56-9-315 – 56-9-317;

. . . .

(b) The enumeration in this section of the powers and authority of the liquidator shall not be construed as a limitation upon the liquidator, nor shall it exclude in any manner the liquidator's right to do such other acts not herein specifically enumerated or otherwise provided for, as may be necessary or appropriate for the accomplishment of or in aid of the purpose of liquidation.

The powers of a liquidator set forth in Tenn. Code Ann. § 56-9-310, though broad, provide no indication that the remedy of a constructive trust is or should be excluded or that the liquidator's redress is or should be limited to those found in Tenn. Code Ann. § 56-9-315 and 317. To the contrary, the chapter expressly provides that it shall not be interpreted to limit the powers granted the Commissioner by other provisions of the law, that the chapter shall be liberally construed, and that the purpose of the chapter is the protection of insureds, claimants, and the public generally. Accordingly, we find Access' narrow reading of the chapter without merit.

Conclusion

Accordingly, the judgment of the Chancery Court of Davidson County, Tennessee, including specifically the imposition of a constructive trust on the disputed funds with an effective date of October 16, 2001, is affirmed. This matter is remanded with costs of appeal assessed against the appellants.

FRANK G. CLEMENT, JR., JUDGE